TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 12-26

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This ruling is based on the particular facts and circumstances presented, and is an interpretation of the law at a specific point in time. The law may have changed since this ruling was issued, possibly rendering it obsolete. The presentation of this ruling in a redacted form is provided solely for informational purposes, and is not intended as a statement of Departmental policy. Taxpayers should consult with a tax practitioner before relying on any aspect of this ruling.

SUBJECT

Whether a limited liability company that is disregarded for federal income tax purposes to an entity described in Section 401(a) of the Internal Revenue Code of 1986, as amended, is considered a not-for-profit entity for Tennessee franchise and excise tax purposes.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

(A) The taxpayer must not have misstated or omitted material facts involved in the transaction;

(B) Facts that develop later must not be materially different from the facts upon which the ruling was based;

(C) The applicable law must not have been changed or amended;

(D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and

(E) The taxpayer directly involved must have acted in good faith in relying upon the ruling; and a retroactive revocation of the ruling must inure to the taxpayer's detriment.

FACTS

[GOVERNMENTAL PLAN] is a "governmental plan" within the meaning of Section 414(d) of the Internal Revenue Code of 1986, as amended, and is an organization described in Section 401(a) and the relevant U.S. Treasury regulations. [REDACTED]. [GOVERNMENTAL PLAN] is not a corporation; rather, [GOVERNMENTAL PLAN] is treated as a trust under Treas. Reg. § 301.7701-4.

[GOVERNMENTAL PLAN] is the sole member of [ENTITY NAME], a [REDACTED] limited liability company ("IntermediateCo I"). Intermediate Co I is the sole member of [ENTITY NAME], a [REDACTED] limited liability company ("IntermediateCo II"). IntermediateCo II is the sole member of [TAXPAYER], a limited liability company (the "Taxpayer"). IntermediateCo I, IntermediateCo II, and the Taxpayer are disregarded for federal income tax purposes. Accordingly, the Taxpayer is treated as a division of [GOVERNMENTAL PLAN] for federal income tax purposes under Treas. Reg. § 301.7701-2(a).

The Taxpayer's sole purpose for existence is [TO HOLD PROPERTY] located in Tennessee and to pay the income therefrom, less expenses, to [GOVERNMENTAL PLAN].

RULING

Is the Taxpayer subject to the Tennessee franchise and excise taxes?

> Ruling: For Tennessee franchise and excise tax purposes, the Taxpayer is a not-for-profit entity. The Taxpayer is therefore generally not subject to Tennessee franchise and excise taxation.
>
> However, as a not-for-profit entity, the Taxpayer is subject to the Tennessee excise tax to the extent its net earnings constitute unrelated business taxable income as defined in I.R.C. § 512, or are otherwise subject to income taxes under Subchapter A of the Internal Revenue Code. Additionally, the Taxpayer is subject to the Tennessee excise tax on all net earnings that are attributable to any activities unrelated to and outside the scope of the activities that give it exempt status.
>
> Similarly, the Taxpayer is subject to the Tennessee franchise tax with respect to its Tennessee net worth, or real or tangible personal property owned or used, that is attributable to activities subject to income taxes under I.R.C. § 512 or any other provision of Subchapter A of the Internal Revenue Code. Additionally, the Taxpayer is subject to the franchise tax on all of its Tennessee net worth, or real or tangible personal property owned or used, that is attributable to any activities that are unrelated to and outside the scope of the activities that gave the Taxpayer its exempt status.

ANALYSIS

Tennessee imposes an excise tax at the rate of 6.5% on the net earnings of all persons, as defined under TENN. CODE ANN. § 67-4-2004(37) (Supp. 2012), doing business within Tennessee. TENN. CODE ANN. § 67-4-2007(a) (2011). Tennessee also imposes a franchise tax at the rate of $0.25 per $100, or major fraction thereof, on the net worth of a person doing business in Tennessee, pursuant to TENN. CODE ANN. §§ 67-4-2105(a), -2106(a) (2011). Persons subject to the Tennessee franchise and excise taxes include, but are not limited to, limited liability companies. TENN. CODE ANN. § 67-4-2004(37).

The Taxpayer is a limited liability company doing business within Tennessee. Accordingly, the Taxpayer will be subject to Tennessee franchise and excise taxation, unless an exemption or exclusion from taxation applies.

One such exclusion from the Tennessee franchise and excise taxes generally applies to persons having not-for-profit status. TENN. CODE ANN. §§ 67-4-2007(a), -2105(a). The term "not-for-profit" is defined as "any person described in §§ 401, 408, 408A, 409, 501, 526, 527, 528, 529 or 530 of the Internal Revenue Code, codified in 26 U.S.C. §§ 401, 408, 408A, 409, 501, 526, 527, 528, 529 or 530." TENN. CODE ANN. § 67-4-2004(33). I.R.C. § 501(a) is applicable here, exempting from federal income taxation "[a]n organization described in subsection [501](c) or (d) or section 401(a)."[1]

[GOVERNMENTAL PLAN] is a "governmental plan" within the meaning of I.R.C. § 414(d) and is an organization described in I.R.C. § 401(a). As an organization described in I.R.C. § 401(a), [GOVERNMENTAL PLAN] is exempt for federal income tax purposes under I.R.C. § 501(a). The Taxpayer is disregarded to [GOVERNMENTAL PLAN] for federal income tax purposes, and as such is treated as a division of [GOVERNMENTAL PLAN] for federal income tax purposes. *See* Treas. Reg. § 301.7701-2(a). As a division of [GOVERNMENTAL PLAN], the Taxpayer is exempt for federal income tax purposes to the same extent, and pursuant to the same Internal Revenue Code provisions, as [GOVERNMENTAL PLAN]. Thus, the Taxpayer is exempt for federal income tax purposes under I.R.C. § 501(a) as an organization described in I.R.C. § 401(a).

Because the Taxpayer is an organization described in I.R.C. § 401(a), it is a "not-for-profit" for purposes of the Tennessee franchise and excise taxes. The Taxpayer is therefore generally not subject to Tennessee franchise and excise taxation.

Note that the determining factor with respect to exemption from the franchise and excise taxes as a not-for-profit is whether the Taxpayer is a "person described in I.R.C. §§ 401, 408, 408A, 409, 501, 526, 527, 528, 529 or 530." *See* TENN. CODE ANN. § 67-4-2004(33). Importantly, the determination of whether the Taxpayer is a person described in one of these sections of the Internal Revenue Code depends entirely on whether the Taxpayer is disregarded to [GOVERNMENTAL PLAN] *for federal income tax purposes*. As explained above, the Taxpayer is a person described in I.R.C. § 401(a) because, for federal income tax purposes, it is disregarded to [GOVERNMENTAL PLAN], which is a person described in I.R.C. § 401(a). In fact, under the facts presented, the Taxpayer would come within the definition of "not-for-profit" under TENN. CODE ANN. § 67-4-2004(33) regardless of whether it is treated as a separate or disregarded entity for franchise and excise tax purposes.[2]

Despite generally being excluded from Tennessee franchise and excise taxation as a not-for-profit entity, the exclusion for such entities is not absolute. Unless it qualifies for an applicable exemption, a not-for-profit entity is subject to the Tennessee excise tax to the extent its net earnings constitute unrelated business taxable income as defined in I.R.C. § 512, or are otherwise subject to income taxes under Subchapter A of the Internal Revenue Code. TENN. CODE ANN. § 67-4-2007(a). Additionally, a not-for-profit entity is subject to the Tennessee excise tax on all

[1] I.R.C. § 501(a) also contains exceptions that do not apply in the Taxpayer's case.

[2] *See* TENN. CODE ANN. §§ 67-4-2007(d), -2007(e)(1), -2106(c); 48-101-706 (2012). Because it is not relevant with respect to the determination of whether the Taxpayer comes within the definition of "not-for-profit" under TENN. CODE ANN. § 67-4-2004(33), this letter ruling will not address whether the Taxpayer is treated as a separate or disregarded entity for franchise and excise tax purposes.

net earnings that are attributable to any activities unrelated to and outside the scope of the activities that give it exempt status. *Id*.

Similarly, unless it qualifies for an applicable exemption, a not-for-profit entity is subject to the Tennessee franchise tax with respect to its Tennessee net worth, or real or tangible personal property owned or used, that is attributable to activities subject to income taxes under I.R.C. § 512 or any other provision of Subchapter A of the Internal Revenue Code. TENN. CODE ANN. § 67-4-2105(b). Additionally, a not-for-profit entity is subject to the franchise tax on all of its Tennessee net worth, or real or tangible personal property owned or used, that is attributable to any activities that are unrelated to and outside the scope of the activities that gave it exempt status. *Id*.

Consequently, if any of the aforementioned criteria are applicable to the Taxpayer, it will be subject to Tennessee excise and franchise taxes to the extent indicated above.

Kristin Husat
General Counsel

APPROVED: Richard H. Roberts
Commissioner of Revenue

DATE: 11-14-12